Notes on Recording Fixed Asse

1. Definition and Scope

- **Fixed Assets (PPE)**: Tangible assets acquired for use in operations (not for resale) with a useful life >1 year and not easily convertible to cash. Examples: land, buildings, machinery, furniture, vehicles.
- **Key Principle**: Recorded at historical cost (acquisition cost) under the cost principle. This includes all costs necessary to bring the asset to its intended location and condition for use (ASC 360-10-30-1).
- **Exclusions**: Intangible assets (e.g., patents), current assets (e.g., inventory), or investment properties (unless held for use).
- **CMA Tip**: Distinguish from expenses—costs that don't provide future economic benefits are expensed immediately (e.g., routine maintenance).

2. Initial Recognition and Measurement

- **When to Recognize**: When it's probable that future economic benefits will flow to the entity and the cost can be reliably measured.
- **Historical Cost Components**:
    - Purchase price (net of trade discounts, rebates, or cash discounts taken).
    - Directly attributable costs: Freight/shipping, handling, insurance during transit, installation, assembly, testing/calibration, site preparation (e.g., modifying a structure or factory floor), professional fees (e.g., legal/architectural), and import duties/taxes.
    - **Exclusions**: General overhead, abnormal waste, staff training (considered operating expenses), advertising/promotion, or relocation costs after initial setup.
- **Examples from Questions**:
    - Machine purchased for $50,000 cash + $100,000 note: Capitalize $150,000 + insurance in transit + freight/handling + assembly/installation. Exclude interest on note (financing cost, expensed as incurred).
    - Equipment for $100,000 + $5,000 freight + $3,000 installation + $2,000 testing + $1,000 structure modification = $111,000 capitalized.
    - Machinery for $150,000 (less $2,500 discount) + $7,000 freight + $5,000 installation + $3,000 testing + $4,000 floor modification = $166,500. Exclude $2,000 training.
    - Machine for $63,000 + $2,500 shipping + $4,000 installation + $3,000 testing = $72,500. Exclude $1,290 interest (not qualifying for capitalization).

- **CMA Pitfall**: Always net out discounts taken; if not taken, they are financing costs (interest expense).

If the Discount Is Taken:

- It **reduces the asset's cost**.
- Example: Machinery priced at $150,000 with a $2,500 discount for early payment → **Capitalized cost = $147,500**.
- This aligns with **ASC 360-10-30-1**, which says the asset should be recorded at **historical cost**, including all necessary costs to bring it to use—but **net of any discounts**.

If the Discount Is Not Taken:

- It's treated as a **financing decision**, not part of the asset's cost.
- The extra amount paid is considered **interest expense**, not capitalized.
- Why? Because the company chose not to take the discount, effectively incurring a cost for delayed payment—similar to borrowing.

Accounting Treatment:

Scenario	**Asset Cost Includes Discount?**	**Excess Cost Treated As**
Discount **taken**	Yes	—
Discount **not taken**	No	Interest Expense

3) Interest Capitalization

General Rule

- **Purchased Assets**: Interest is *not* capitalized.
  - Treated as a **financing cost**, expensed as incurred.
  - Example: Buying a machine with a loan—interest is **not** part of asset cost.

Exception: Self-Constructed Assets

- Interest **can be capitalized** if:
  - The asset is **constructed internally**.
  - It requires **significant time** to prepare for intended use.
  - Examples: Construction of a factory, ship, or custom machinery.

Qualifying Assets

- Must be:
    - **Discrete**, long-term construction projects.
    - **Not** routine production or inventory.
- Examples:
    - ✅ Building a corporate HQ → qualifies.
    - ❌ Manufacturing 10,000 units of a product → does not qualify.

✅ Amount to Capitalize

Formula:

Avoidable Interest = **Weighted-Average Accumulated Expenditures** × **Capitalization Rate**

- **Weighted-Average Accumulated Expenditures**: Average amount spent on the asset during the construction period.
- **Capitalization Rate**: Weighted-average interest rate on borrowings.
- **Cap Limit**: Cannot exceed actual interest incurred during the period.

✅ Capitalization Period

- Begins: When **construction activities start** (e.g., planning, expenditures).
- Ends: When the asset is **substantially complete and ready for use**.
- Suspend: If construction **pauses** for extended periods.

✅ CMA Exam Tips

- **Purchased Asset**: Interest is always expensed.
    - *Example*: $100,000 machine bought with a loan → interest is **not** capitalized.
- **Internally Constructed Asset**: Interest may be capitalized.
    - *Example*: Building a plant over 6 months → interest during that time may be capitalized.
- **No Borrowings?** → No interest to capitalize.
- **Asset Ready Immediately?** → No capitalization period.
- **Use the formula**: Average expenditures × Rate.
- **Watch for traps**: Interest on idle funds or delays not related to construction is **not** capitalized.

4. Special Cases in Recording

Basket Purchases

When two or more assets are bought together for one price, allocate that lump-sum cost based on each asset's relative fair value at acquisition.

- Calculate each asset's weight: fair value of asset ÷ total fair value.
- Multiply the total purchase price by each weight. Example: combined land + building cost $200,000; land's FMV is 40% of the pair → $200,000 × 40% = $80,000 to land, $120,000 to building.

Asset Exchanges: Commercial vs. Non-Commercial Substance

With Commercial Substance

Definition: Occurs when the exchange **significantly changes future cash flows**—for example, different risk, timing, or amount of cash flows.

Accounting Treatment:

- Record the new asset at **fair value** of the asset given up (or received, if more reliable).
- Adjust for **cash paid or received**.
- **Recognize gain or loss immediately**.

Formula: **Gain/Loss** = (Fair value of asset given up + Cash received) − Book value of asset given up

Example:

- Book value of old machine: $50,000
- Fair value of old machine: $70,000
- Cash received: $5,000
- Gain = ($70,000 + $5,000) − $50,000 = **$25,000 gain**

Without Commercial Substance

Definition: No significant change in future cash flows—assets are similar in nature and use.

Accounting Treatment:

- Record new asset at **book value** of asset given up + any **cash paid**.
- **Do not recognize gains** (defer them).
- **Recognize losses immediately**.

Example:

- Book value of old truck: $40,000
- Fair value: $45,000
- Cash paid: $2,000
- New truck recorded at: $40,000 + $2,000 = **$42,000**

- **No gain recognized**, even though fair value is higher.

⚠ **CMA Exam Pitfalls**

- **Always check for commercial substance**—this drives the entire treatment.
- **Cash received in non-commercial exchanges** may trigger partial gain recognition (if boot is <25% of total consideration).
- **Losses are always recognized**, regardless of substance.
- **Fair value is used only when commercial substance exists**.

Donated Assets

Assets received for no or nominal consideration.

- Record at the fair market value on the donation date.
- Credit a donation-revenue or gain account for the same amount.

Lump-Sum Acquisitions

Identical to basket purchases: allocate a single price among multiple assets based on each asset's appraised value percentage.

5. Subsequent Costs – Capitalize vs. Expense

After a fixed asset is acquired and placed into service, companies often incur additional costs. The key accounting decision is whether to **capitalize** these costs (add them to the asset's value) or **expense** them immediately.

□ Capitalize If the Cost:

These costs are added to the asset's book value because they enhance its future economic benefits.

- **Extends Useful Life** Example: Replacing a major component that allows the asset to operate longer than originally expected.
- **Increases Capacity or Efficiency** Example: Upgrading machinery to produce more units per hour.
- **Improves Quality or Functionality** Example: A major overhaul that makes the asset perform better than before.

These are considered **improvements** or **betterments**, and they are capitalized under ASC 360-10 because they change the nature or value of the asset.

□ Expense If the Cost:

These are routine costs that maintain the asset's current condition and do not enhance its value.

- **Routine Maintenance** Example: Oil changes, filter replacements, or minor repairs.

- **Repairs to Maintain Normal Operating Condition** Example: Fixing a broken part that restores the asset to its original state.

These are **period costs** and are expensed immediately in the income statement.

CMA Exam Tip:

- **Additions**: New assets or components added to existing ones → **Capitalize**
- **Improvements**: Enhance existing asset's performance or life → **Capitalize**
- **Maintenance/Repairs**: Restore original condition without enhancement → **Expense**

Example from CMA Questions:

If a company spends $10,000 to upgrade a machine's motor to increase production speed, **capitalize** it. If it spends $500 to replace worn-out belts during routine servicing, **expense** it.

6. Presentation on Financial Statements

- **Balance Sheet (Statement of Financial Position)**: Reported at carrying value (net book value) = Historical cost - Accumulated depreciation (for depreciable assets). Land is not depreciated.
- **Examples from Questions**: PPE value = Cost - Accum. Dep. (e.g., not replacement cost, appraisal value, or gross cost alone).
- **Disclosure Requirements**: Cost, accum. dep., depreciation methods/rates, useful lives, pledges/liens, and impairments.
- **CMA Tip**: Gross cost remains unchanged unless additions/retirements; accum. dep. increases over time.

7. T-Account Analysis for PPE Changes

- **To Calculate Purchases or Sales**: Use beginning/end balances of PPE (gross) and accum. dep.
- **Formula**:
    - Ending PPE (gross) = Beginning PPE + Purchases - Cost of disposals.
    - Ending Accum. Dep. = Beginning Accum. Dep. + Dep. Expense - Accum. Dep. on disposals.
    - Net Book Value (NBV) = PPE (gross) - Accum. Dep.

Example from CMA Question

Let's say:

- Beginning PPE (gross): $224,000
- Beginning Accum. Dep.: $64,000
- Asset sold: Original cost $30,000, Accum. Dep. on sale $29,000

- Ending PPE (gross): $300,000
- Ending Accum. Dep.: $80,000

Step 1: Calculate Purchases

Code

Purchases = Ending PPE − (Beginning PPE − Cost of Disposals)

Purchases = $300,000 − ($224,000 − $30,000) = $106,000

Step 2: Calculate Depreciation Expense

Code

Dep. Expense = Ending Accum. Dep. − (Beginning Accum. Dep. − Accum. Dep. on Disposals)

Dep. Expense = $80,000 − ($64,000 − $29,000) = $45,000

 CMA Tips

- **Ignore gains/losses** on disposal when calculating gross PPE changes.
- **Always reconcile both PPE and Accum. Dep. accounts**—they move together.
- **Partial data is common** in exam questions—use T-account logic to solve for missing values.
- **NBV is not enough**—you need gross and accumulated balances to analyze asset activity.

8. Additional CMA-Relevant Information

- **Impairment (ASC 360-10-35)**: Test if indicators exist (e.g., market decline). Recoverable amount = Undiscounted future cash flows. If < carrying value, impair to FMV.
- **Depreciation Methods**: Straight-line, units-of-production, declining balance—chosen based on usage pattern (covered in separate CMA topic but ties to recording).
- **IFRS vs. U.S. GAAP**: IFRS allows revaluation model (to FMV), but U.S. GAAP sticks to cost model. CMA may compare.
- **Tax vs. Book**: Tax uses MACRS; book uses GAAP methods. Deferred taxes arise from differences.
- **Common Exam Traps**: Confusing capitalization vs. expensing; forgetting to net discounts; assuming interest always capitalizes; miscalculating in T-account problems (e.g., ignoring accum. dep. on sales).